

Internal Revenue Service
memorandum

CC:TL-N-6698-90

Br4:RBWeinstock

date: MAY 23 1990

to: District Counsel, Brooklyn CC:BRK
Attn. Ted Leighton

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED]
Statute of Limitations under I.R.C. §§ 4941 and 4945

This is in response to your request for tax litigation advice with respect to certain statute of limitation issues raised by the petition in this recently filed Tax Court case. For the reasons stated below, we believe that the statute of limitations expired with respect to the transactions occurring in [REDACTED] and [REDACTED] that constituted alleged acts of self dealing under I.R.C. § 4941, and taxable expenditures under I.R.C. § 4945, for which the Service issued a notice of deficiency to the petitioner.

ISSUES

1. Whether the statute of limitations on assessment has expired with respect to certain acts of self-dealing and taxable expenditures.
2. Whether a Form 872 executed by a disqualified person on behalf of a private foundation serves to extend the statute of limitations with respect to a different disqualified person who did not execute a Form 872.
3. Whether, in cases involving certain continuing transactions which under Treas. Reg. § 53.4941-1(e) give rise to a new act of self-dealing on the first day of each subsequent taxable year or portion of taxable year in the taxable year, a separate statute of limitations exists with respect to each deemed transaction.

CONCLUSION

1. The statute of limitations with respect to a disqualified person runs from the filing of the private foundation's return. Based on the facts presented, and notwithstanding whether a three year or six year statute of limitations period applies, the statute of limitations has expired (with the possible exception of any deemed transactions).

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2. A foundation's execution of an extension of the statute of limitations does not extend the limitations period to a disqualified person who did not himself sign an extension.

3. Each deemed act of self-dealing arising under Treas. Reg. § 53.4941-1(e)(1) from certain continuing transactions has its own statute of limitations. However, the facts suggest that there were no continuing transactions that would give rise to deemed acts in successive taxable years. Therefore, the period for assessment of all of the excise taxes expired prior to the issuance of the statutory notice to [REDACTED]

BACKGROUND

Petitioner was a member of the board of directors, and a foundation manager, for [REDACTED] (the Foundation), a tax-exempt private foundation founded by [REDACTED]. The Foundation uses a taxable year ending on June 30 of each year. In late [REDACTED], [REDACTED]'s law firm reported that he had been misappropriating Foundation funds, often in the form of grants or loans. Various transactions, which the Service has characterized as acts of self-dealing and taxable expenditures, took place in the taxable years ending [REDACTED], [REDACTED], [REDACTED] and [REDACTED]. Petitioner did not file any Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code.

In the Form 990-PF, the private foundation return, for the year ending [REDACTED], the Foundation in completing Part V-Statements Regarding Activities, answered the items relating to self-dealing (Item 10), jeopardizing investments (Item 13), and amounts paid or incurred for nonexempt purposes (Item 14(5)) by referring to an attachment. The attachment provided in pertinent part:

It was reported to [REDACTED] by [REDACTED]'s law firm in late [REDACTED] that [REDACTED] had been misappropriating funds from [the Foundation]. In all cases [REDACTED] was acting without authority and was in breach of his fiduciary responsibilities. In some cases [REDACTED] disguised the misappropriated funds from the Foundation as loans for charitable endeavors.

It is our understanding that a similar statement was enclosed with respect to the Form 990-PF for the year ending [REDACTED]. No such statement was included in the return for the year ending [REDACTED], although certain transactions which the notice of deficiency labelled as acts of self-dealing and taxable expenditures were listed as grants in the Form 990-PF for that year. The return for the year ending [REDACTED] has not yet been located by the Service.

The Foundation's Forms 990-PF were filed as follows:

Foundation's Taxable Year Ended

[REDACTED]

Date Form 990-PF Filed

Not known yet

[REDACTED]

A notice of deficiency asserting the excise taxes imposed under I.R.C. §§ 4941 and 4945 was issued to [REDACTED] on [REDACTED]. On [REDACTED], [REDACTED] filed a petition with the Tax Court alleging, among other things, that the excise tax deficiencies are time barred because the statute of limitations on assessment expired prior to the issuance of the statutory notice. This allegation was stated in general terms without discussing why and when he contends the assessment periods expired.

In discussions with the revenue agent from the Brooklyn District who examined the case and the member of the Quality Review Staff that issued the notice, these individuals indicated that they believed the statute of limitations on assessment was open because 1) petitioner had filed no Forms 4720 with respect to the acts of self-dealing so as to start the statute of limitations running; 2) the six-year statute of limitations provided by I.R.C. § 6501(e) was applicable and extended the statute of limitations date beyond [REDACTED] and 3) the Form 872 consent executed on behalf of the Foundation on [REDACTED], extended the statute of limitations on assessment against [REDACTED] to [REDACTED], which extension date was after the date the statutory notice was issued.

You have preliminarily concluded that the Foundation's Forms 990-PF are the returns which determine the statute of limitations for purposes of Section 6501. You have also concluded that Foundation's execution of Form 872 does not serve to extend the statute of limitations against the petitioner and that the statute of limitations has expired with respect to all of the alleged acts of self-dealing. You have further concluded that a single period of limitation exists for an initial continuing transaction and the deemed acts of self-dealing that arise under Treas. Reg. § 53.4941(e)-1(e)(1).

ANALYSIS

1. Statute of Limitations

I.R.C. §§ 4941 and 4945 impose excise taxes on certain acts of self-dealing and taxable expenditures made with respect to private foundations. The tax on acts of self-dealing is imposed upon disqualified persons who participate in the act of self-dealing. The tax on taxable expenditures is generally imposed on the foundation. In

certain cases, a foundation manager is liable for a separate tax on acts of self dealing and taxable expenditures. In this case, the excise taxes were asserted against [REDACTED] as a self-dealer, and as a foundation manager.

I.R.C. § 6501(a) provides a general rule that the Service must make an assessment of tax within three years after a return is filed. I.R.C. § 6501(e)(3) provides, with respect to a private foundation excise tax return, a six year statute of limitations where there is a failure to report 25 percent of the amount of the excise tax reported on the return. In determining the amount of excise tax omitted on a return, there shall not be taken into account any amount of tax which is omitted from the return if the transaction giving rise to such tax is disclosed in the return, or in a statement appended to the return if such item is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Service of the existence and nature of such item.

I.R.C. § 6501(l)(1) provides for purposes of the private foundation excise taxes, the return referred to is the return filed by the private foundation for the year in which the act (or failure to act) giving rise to liability for such tax occurred. Treas. Reg. § 301.6501(n)-1(a) provides for private foundation excise taxes, the filing of the Form 990-PF shall be considered for purposes of Section 6501 to be the return of all persons required to file a return with respect to any such tax arising from such act, notwithstanding that all such persons have not signed the return, or notwithstanding the fact that the foundation may have incorrectly answered certain questions with respect to the excise taxes on the return. See Cline v. Commissioner, T.C. Memo. 1988-144.

Under the Code and Regulations, it is the Foundation's filing of the Form 990-PF which controls the statute of limitations in this case. The fact that the petitioner failed to file a Form 4720 has no effect on the running of the statute. Therefore, depending on whether there was disclosure of the underlying transactions in the tax returns, there will be a three year or six-year statute of limitations applicable to each act of self-dealing and/or taxable expenditure running from the filing of the Form 990-PF.¹

We note that with respect to the tax year ending [REDACTED] even if the listing of certain grants on the return did not constitute disclosure of the underlying transactions, and a six-year statute of limitations applied, the six-year period expired on [REDACTED] prior to the issuance of the deficiency notice, and absent an extension of the statute of limitations, assessment of the taxes for acts of self-dealing and taxable expenditures in that tax-year are time-barred. While you are not certain

¹ For purposes of this discussion, we are assuming each act subject to tax is a discrete completed transaction.

when the foundation filed its return for the tax-year ending [REDACTED] it is likely that return was filed prior to the return for the following year, and the statute of limitations for transactions occurring in that year also has expired.

You are of the view, citing Cline v. Commissioner, that the statement attached to the Form 990-PF for the tax-year ending [REDACTED] constituted adequate disclosure, and therefore a three-year statute of limitations applies. The attachment to the return clearly states that petitioner had been misappropriating funds from the foundation, which are transactions that might fall within I.R.C. §§ 4941, 4944 and 4945. Whether an item is adequately disclosed is a factual question, however, we have no quarrel with your office's view that there was adequate disclosure and a three year statute of limitations applies. Certainly, the Foundation's disclosure went beyond that found in Cline where the foundation asserted that there had been no act of self-dealing. Here, the Foundation referenced its answers as to whether there had been any acts of self-dealing, jeopardizing expenditures, and taxable expenditures, to an attached statement which discussed petitioner's misappropriation of funds. Insofar as a three-year statute applies, the last day a notice could have been issued for taxable events occurring in that tax year was [REDACTED], three years from [REDACTED] when the Foundation filed its return. Therefore, the statute of limitations expired prior to the notice being issued.

You have subsequently located the Foundation's return for the year ending [REDACTED], which was filed on [REDACTED]. You have orally advised us that the Foundation's return contained a similar attachment as the [REDACTED] taxable year return. Accordingly, a three-year statute of limitations also applies to taxable events occurring in this taxable year. The last day for a timely notice of deficiency to be issued was [REDACTED], which was also prior to the issuance of the statutory notice. Accordingly, unless the statute of limitations had been extended, or there were deemed acts occurring in later taxable years, the statute of limitations expired with respect to all acts of self-dealing or all taxable expenditures occurring in the taxable years ending [REDACTED], [REDACTED] and [REDACTED].

2. Effect of Foundation's Execution of Form 872

The second issue involves the effect of a Form 872 executed by [REDACTED] the Foundation's President, on behalf of the Foundation. We agree with your conclusion that the Foundation's execution of a Form 872 does not extend the statute of limitations against [REDACTED].

In GCM 39066, Statute of Limitations for Purposes of Sections 4971 and 4975, Statute of Limitations for Purposes of Section 4941, (EE-83-81, EE 128-81) (November 25, 1983), it was noted that with respect to the excise taxes imposed by I.R.C. §§ 4941 and 4975,

[a]ll disqualified persons who participated in the transaction are jointly and severally liable to pay the tax. When securing extensions of the period of limitations for assessment of excise tax against disqualified persons who are jointly and severally liable for the tax, each disqualified person should sign an extension. Absent other written authority, the signature of any one disqualified person will not bind others who do not personally sign an extension. United States v. Mensik, 381 F. Supp. 672 (N.D. Ill. 1974); Estate of Sperling v. Commissioner, T.C. Memo. 1963-260, aff'd without discussion of this point, 341 F.2d 201 (2d Cir.), cert. denied, 382 U.S. 827 (1965).

While the instant case involves an extension from the Foundation, the applicable authority (Mensik and Estate of Sperling) would preclude using the Foundation's extension as binding [REDACTED]. See also Magaziner v. Commissioner, T.C. Memo. 1957-26.²

3. Statute of Limitations for Deemed Acts

While the statute of limitations appears to have expired with respect to [REDACTED]'s various acts of self-dealing and taxable expenditures, Treas. Reg. § 53.4941(e)-1(e)(1)(ii) provides that in transactions of a continuing nature (e.g., a lease of property, the lending of money, an extension of credit), an act of self-dealing occurs on the date the transaction first occurs, and an additional act of self-dealing occurs on the first day of each subsequent taxable year. Example (2) of Treas. Reg. § 53.4941(e)-1(e)(1)(ii) specifically indicates that the subsequent prohibited acts arising from the initial transaction are to be treated as separate acts of self-dealing occurring in separate taxable periods.

The rule, which is often referred to as "pyramiding" has been upheld by the Tax Court. Lambos v. Commissioner, 88 T.C. 1451-1453 (1987); Rutland v. Commissioner, 89 T.C. 1137, 1150-1151 (1987). It is the Service's position, stated in GCM 38729, Statute of Limitations for Assessment of Section 4941 Tax, (EE-122-79)(Feb. 19, 1980), that separate periods of limitation, rather than one period of limitation commencing with the initial transaction, apply to additional acts of self-

² You suggest that there is an inconsistency between having the Foundation's filing of the Form 990-PF start the running of the limitations period with respect to the disqualified person and the Foundation's consent to extend the statute of limitations not extending the disqualified person's limitations period. However, we note that the Foundation is itself not liable for the Section 4941 tax on self-dealing, nor is it liable for the excise taxes imposed by Sections 4941 and 4945 on foundation managers. Also, the rate of the Section 4941(a) excise taxes depends on the number of years in the taxable period. The mailing of a notice of a deficiency is one of the events that closes that taxable period. If a foundation's extension of the statute of limitations bound the disqualified party, it might also have the effect of also extending the taxable period, and increasing the amount of the disqualified person's excise tax liability.

dealing created under Treas. Reg. § 53.4941(e)-1(e)(1). See also GCM 38846, Statute of Limitations for Purposes of Sections 4971 and 4975, at 12 (EE-83-81) (Feb. 26, 1982) ("Each deemed transaction is then treated like a discrete transaction, and the appropriate statute of limitations may be determined [using applicable rules].").

Your office suggests that this position is inconsistent with the position expressed in GCM 39066, and GCM 38862, Statute of Limitations for Purposes of Section 4941 (EE-128-81) (December 1, 1981). These GCMs concluded that an extension of the statute of limitations need only be secured with respect to the year in which a taxable event (i.e., an act of self-dealing or prohibited transaction) occurred, and that no extension needs be obtained with respect to subsequent taxable years.

We do not read the conclusion in this G.C.M. as dealing with deemed transactions which arise in different years. We also note that the author of these GCM's (who also wrote GCM 38846) specifically stated that "[t]he principles discussed on pages 10-15 of G.C.M. 38846 are not modified by this memorandum except as to the issues addressed below." There was nothing to indicate any change in position with respect to deemed transactions.

The Service has asserted in the Tax Court that each deemed transaction arising out of a continuing transaction has its own statute of limitations. We previously sent your office a copy of the relevant portion of the Service's brief in Rutland, as well as a Memorandum of Authorities submitted in [REDACTED] and [REDACTED]. In the [REDACTED] memorandum, we stated, "It is evident, therefore, that with pyramiding, the six-year statute of limitations applies not only to the amounts first loaned in the taxable year, but to those amounts which are deemed to be an additional prohibited transaction in that year as well." While these case involve the tax on prohibited transactions under I.R.C. § 4975, the principles are equally applicable here. Thus, it is the Service's position that a separate statute of limitation applies to each deemed act of self-dealing.

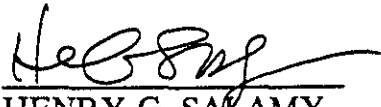
It is unclear in the instant case whether there were any continuing transactions to give rise to deemed acts of self-dealing in years for which the statute of limitations has not expired. We note that the statement attached to the Foundation's Form 990-PF refers to the misappropriation of funds by [REDACTED] which are characterized in the Foundation's books as purported loans for charitable endeavors. While loans of money are continuing transactions, it is not proper to characterize the misappropriation of funds as loans. Unless there were actual loans that constituted acts of self-dealing, there are no deemed transactions under Treas. Reg. § 53.4941(e)-1(e)(1).

Because [REDACTED] misappropriated the funds for his own personal use, he should have included such funds in his personal income tax returns. To the extent the statute of limitations on his individual tax returns has not expired because of either a

substantial understatement of income or the filing of a fraudulent returns, deficiencies should be asserted against him on this basis. Coordination should be made with the Examinations function.

We have informally coordinated the conclusions reached herein with the Exempt Organizations Technical Division. If you have any questions or require further assistance, please contact Ronald Weinstock at FTS 566-3345.

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